COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF VALLEY GAS, INC. FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 92-407

O R D E R

On November 13, 1992, Valley Gas, Inc. ("Valley Gas") filed its application for Commission approval to increase its gas rates. Commission Staff, having performed a limited financial review of Valley Gas's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 8th day of March, 1993.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF VALLEY GAS, INC. FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 92-407

STAFF REPORT

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STAFF REPORT

ON

VALLEY GAS, INC.

Case No. 92-407

A. Preface

On November 13, 1992, Valley Gas, Inc. ("Valley") filed an application for a rate adjustment pursuant to 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities ("ARF"). Valley did not meet the minimum requirements for an ARF filing due to its level of revenues and number of customers, therefore, Valley requested a waiver of the requirements. The Commission granted Valley a deviation from the ARF procedure by Order dated October 1, 1992. The rates proposed by Valley would generate approximately $30,400 in additional annual revenues or approximately 23 percent based on normalized test-year sales.

The Commission Staff performed a limited financial review of Valley's operations for the test year ending December 31, 1991. The Commission's objective was to reduce or eliminate the need for written data requests, decrease the time necessary to examine the application and, therefore, decrease the expense to the utility. Tammy Page of the Commission's Division of Financial Analysis performed the staff review on December 9-10, 1992 at the offices of Valley, in Irvington, Kentucky. This report was prepared by Ms. Page, with the exception of the section dealing with Revenue Requirements, which was prepared by Gary Forman of the Commission's Division of Financial Analysis. The sections dealing with

Normalized Revenues, Purchased Gas Costs, and Retail Rates, were prepared by Jordan C. Neel of the Commission's Division of Rates and Research.

Scope

The scope of the review was limited to obtaining information to determine that the operating expenses as reported in Valley's application for the period ending December 31, 1991 were representative of normal operations, and to gather information to evaluate the pro forma adjustments proposed in Valley's filing. Expenditures charged to test-year operations were reviewed, including any supporting invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Test Year Restatements

The Statement of Income for the Year ("Statement of Income") contained in the 1991 Annual Report for Valley was the primary financial document analyzed in this review. While this document generally presented the financial transactions of Valley in the manner prescribed in the Uniform System of Accounts for Class C and D Gas Utilities ("USoA"), the Staff did note exceptions to these requirements. Valley maintained its records on an accrual basis of accounting as required by the USoA, therefore, Staff was able to relate Valley's accounting records to the Statement of Income. Because of the exceptions noted to the Statement of Income, Staff has made the following modifications:

Office Supplies and Expenses, Account No. 921

During the field review, Staff discovered that Valley had included donations of $385 in this account. As described in the USoA, all donations which are considered for charitable, social or community welfare purposes should be included in Account 426.1, "Donations". This is a below the line expense and is deemed a non-utility deduction. Accordingly, Staff has removed $385 from Account No. 921 and included this amount as a non-utility deduction in Account 426.1.

Gas Service Revenues

Valley reported residential sales for the test year of $179,306 and commercial and industrial sales of $64,690, for total Gas Service Revenues of $243,996. During the review process, Staff determined that the reported revenues and expenses included taxes collected by Valley which were to be remitted to state and county governments. The taxes had been reported as Gas Service Revenues and as Taxes Other Than Income Taxes. Taxes which are collected by the utility and remitted to various governmental units should not be reflected in the utility's Statement of Income.

The Kentucky sales taxes collected and remitted totaled $1,584 and the Breckenridge County utility receipts tax totaled $7,056, for a total collection and remittance of $8,640. At the time of billing, these taxes should be reflected as Accounts Payable, and the balance in that account reduced when the taxes are paid. These taxes represent neither revenue nor expenses of the utility and, therefore, Staff has removed $8,640 from the Gas Service Revenues Account.

Taxes Other Than Income Taxes

Valley reported items which represented collections and remittances for governmental agencies as Taxes Other Than Income Taxes. As indicated in the previous section of this report, these taxes are not reported as an operating expense under the USoA. Therefore, Staff has removed $1,584 in Kentucky sales taxes and $7,056 in Breckenridge County utility receipts tax, or a total of $8,640, from the test year restatement.

The following Statement of Income reflects the Staff reclassifications pursuant to the USoA. The adjusted amounts will be used for the test period for rate-making purposes:

Valley Gas, Inc.
Restated Income Statement
For the Test Period Ended
December 31, 1991

	Balance Per Books	Review Reclassi-fication	Adjusted Balance
Operating Revenues:			
Gas Service Revenues	$ 243,996	$(8640)	$ 235,356
Misc. Revenues	5,227	-0-	5,227
Total Operating Revenues	$ 249,223	$(8640)	$ 240,583
Operating Expenses:			
Natural Gas Purchases	$136,366	$ -0-	$136,366
Mains & Services	382	-0-	382
Rents	21	-0-	21
Maintenance of Lines	351	-0-	351
Maintenance of Meters	734	-0-	734
Account. & Collect.	1,319	-0-	1,319
Supplies & Expenses	2,231	-0-	2,231
Uncollectible Accounts	688	-0-	688
Admin. & Gen. Salaries	31,300	-0-	31,300
Office Supplies & Exp.	2,568	(385)	2,183
Outside Services	26,125	-0-	26,125
Property Insurance	1,078	-0-	1,078
Employee Pensions	4,680	-0-	4,680
General Advertising	705	-0-	705
Misc. General Exp.	293	-0-	293
Rents	6,000	-0-	6,000
Transportation Exp.	2,025	-0-	2,025
Depreciation	6,298	-0-	6,298
Taxes Other Than Income Taxes	12,661	(8640)	4,021
Total Operating Exp.	$ 235,825	$ (9025)	$ 226,800
Net Operating Income	$ 13,398	$ 385	$ 13,783
Other Income:			
Interest & Dividends	$ 1,993	$ -0-	$ 1,993
Other Deductions:			
Non Utility	$ -0-	$ 385	$ 385
Other Interest Exp.	331	-0-	331
NET INCOME	$ 15,060	$ -0-	$ 15,060

C. Recommended Rate-Making Adjustments

Normalized Revenues From Sales

Staff projects Valley's normalized sales revenues to be $279,613 based on sales of 49,231 Mcf. This amount is supported by an analysis of average billing and is based on retail rates in effect at the time the rate case was filed, as approved in Case No. 89-103-D.[1]

Purchased Gas Adjustment Clause

The most current purchased gas adjustment approved by the Commission prior to the issuance of the final Order in this case should be incorporated into normalized revenues and natural gas purchases at the time the Final Order is issued.

Natural Gas Purchases

During the test period, Valley had gas purchases of 50,803 Mcf and gas sales of 49,231 Mcf. This represents a line loss of 3.1 percent. This percentage of line loss is within the range traditionally allowed by this Commission. Valley's normalized purchased gas expense of $203,446 is based on rates reflected in Case No. 89-103-D.

Distribution Expenses

Mains and Services Supplies and Expenses, Rents, Maintenance of Lines, and Maintenance of Meters. Valley proposed an overall increase of $5,000 to these accounts which includes additional pipe and related materials needed to upgrade, maintain, and expand the

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1 Case No. 89-103-D, The Notice of Gas Cost Adjustment Filing of Valley Gas, Inc., Order dated October 23, 1992.

system. Without adequate documentation of the nature of the costs, Staff cannot determine whether they should be expensed or capitalized. Furthermore, without specific plans on how or when these costs will be incurred, Staff cannot consider the adjustment to be known and measurable. Staff recommends that this adjustment be excluded for rate-making purposes.

Valley reported a balance of $382 in the annual report for Mains and Services Supplies and Expenses. Included in this balance is a payment to Consumer Reports for magazine subscriptions of $167. Consumer Reports is not an industry specific magazine and does not provide information essential to operating a gas utility, therefore, Staff recommends that $167 be disallowed for rate-making purposes which results in an adjusted balance of $215.

<u>Administrative and General Expenses</u>

Administrative and General Salaries. After reviewing Valley's records, Staff became aware of two bonuses that the two employees of Valley received during the test year. A $250 bonus was given to each employee at Christmas and a $1,000 bonus per employee was given at June 30, 1991. Staff has not included these bonuses in the revenue requirements of Valley due to the fact that Valley has not shown that this cost is required to make the employees' compensation adequate and there is no guarantee these bonuses will recur next year.

Valley proposed a 10 percent increase to this account, which would result in an increase of $3,200. Valley feels that the increase is needed to keep wages competitive. No evidence or analysis was provided to substantiate that a 10 percent increase in wages was necessary, and Valley has not actually granted the wage increase to employees at this time. Therefore, Staff has not included this proposed adjustment.

In summary, Staff has made an adjustment to decrease test year wages by $2,500 to reflect the exclusion of the bonuses, which results in a balance of $28,800.

Office Supplies and Expenses. Valley proposed an increase of $4,500 in this account which includes software upgrades and additional supplies needed for billing purposes. As explained in a later section outlining computer billing, Valley has not yet started generating its own bills. Staff cannot include an increase for something that has yet to occur and may not happen for quite some time.

Valley informed Staff that it had spent $68 on software upgrades in 1992. Staff cannot recognize this amount due to the fact that computer billing will not occur until the future, and the purchase of software is not an annual recurring expense for a utility the size of Valley.

During the review, Staff discovered that the test year level of Office Supplies and Expenses included the following: Telephone $955, Travel $74, Miscellaneous $58, Water & Garbage $384, and Electric $780. This results in a test year level of expense of $2,251. The miscellaneous expense consists of $27 to Pat's Florist and $31 to Houchen's Market. Staff has excluded these two amounts for rate-making purposes. After excluding these two amounts, this results in an adjusted balance of $2,193. Valley informed Staff during the field review that the annual expense for water, garbage, and electric had increased as of December 1, 1992. However, Valley did not propose an adjustment for this increase in these expenses.

Outside Services. Valley proposed two adjustments to Outside Services. The first adjustment is a 10% increase in the $24,000/year management fee. The second adjustment is an increase of $5,000 for professional fees, expected construction, and other regulatory matters. Valley reported $26,125 for Outside Services in the annual report. Valley has a service agreement in effect with Irvington Gas Company ("Irvington") in which a management fee of $12,000 semi-annually is charged. Outside Services consist of these 2 semi-annual payments of $12,000 each, $625 for an audit performed by York, Neel & Co, and $1,500 to John Hughes for legal services provided. During the field review, Staff was informed of a service agreement between Valley and Irvington for 1993. This service agreement reflects that Valley has not paid for the 10 percent increase in the management fee at this time. Staff recommends that since the management fee has not changed in the 1993 service agreement, the increase should not be recognized for rate-making purposes.

The second adjustment to Outside Services was a proposed $5,000 increase in professional fees, expected construction, and for other regulatory matters. Valley did not provide any information to substantiate that the additional costs would be incurred or that this adjustment was necessary. In the absence of any justification for this level of expense it can not be considered known and measurable. Therefore, Staff recommends that this adjustment be denied.

Property Insurance. Valley proposed to increase this account by $350. Valley reported a balance of $1,077 for this account for the test year. During the field review, Valley informed Staff that its insurance company had gone bankrupt during the test year. Therefore, Valley had to acquire property insurance from a new company. Staff's review of the insurance policies for the test year revealed that insurance expense for 1991 was actually $2,661. Valley did not adjust the annual report to reflect the change from $1,077 to $2,661 in insurance expense. Staff recommends an increase of $1,583 to reflect the actual test year insurance expense.

Pensions and Benefits. Valley proposed a $495 increase in pension expense to reflect the proposed wage increase. As discussed in the Administrative and General Salaries section, Valley should have a balance of $28,800 for wages. Valley funds its pensions on the basis of 15% of the gross amount of the wages. Staff recalculated pensions, based on the staff adjusted wages of $28,800 and concluded that the pension expense should be decreased by $360.

During the field review, Valley informed Staff that its two employees were now being covered by medical insurance. Insurance for the two employees costs $133.06 each per month which results in an annual charge of $3,193.44. Valley did not propose an adjustment for the increased cost of medical insurance. However, this is a valid expense for rate-making purposes and should be included in determining the revenue requirements of Valley.

Valley reported total Pensions and Benefits of $4,680 for the test year. With both of the adjustments, Pensions and Benefits should be increased $2,833, resulting in a balance of $7,513.

Accounting and Collecting. Valley obtained billing services during the test year from The Computing Center. Valley proposed to eliminate this expense of $1,678 because a new computer system was purchased allowing Valley to generate its own bills. However, during the field review, Valley informed Staff it does not plan on generating its their own bills until mid-1993. Valley estimated the cost of doing its own billing in the amount of $376. This amount included the price of bills and the annual postage. However, Valley could not determine how much time would be involved in generating the bills nor was information available to determine whether there would be any increased labor costs to Valley. Staff cannot recognize this proposal because Valley was not preparing its bills in-house during the test year and is not planning to generate its bills until mid-1993. The cost of providing in-house billing is not yet known and measurable. Valley reported computer billing at a cost of $1,319 in the annual report and Staff has verified this expenditure. Staff has included the actual documented level of computer billing cost of $1,319 for rate-making since the billing services arrangement will remain effective subsequent to the test year.

General Advertising. Valley proposes to increase advertising expense by $100. This increase would cover increased costs of newspaper and other local advertising. 807 KAR 5:016 provides that, "Advertising expenditures for .... institutional advertising by electric or gas utilities shall not be considered as producing a material benefit to the rate payers and, as such, those expenditures are expressly disallowed for rate-making purposes." The regulation further states that "institutional advertising" means advertising which has as its sole objective the enhancement or preservation of the corporate image of the utility and to present it in a favorable light to the general public." Valley Gas had the following expenditures for the test year:

Meade County Fair	$100.00
BCHS Tiger Tales	35.00
Advertising Ideas	286.63
Advertising Ideas	283.98
	$705.61

Based on the nature of the advertisements, Staff believes that all of these should be considered institutional and, therefore, not allowable for rate-making purposes. Advertising expense has been reduced by $705.61.

Transportation Expense. Valley reported total transportation expense of $2,025 for the test year. Valley proposed an increase of $1,000 to this account which includes the cost of operating a trencher and additional maintenance for the truck. While there may be an increased cost for this expense due to additional equipment, without any documentation Staff cannot recommend an increase of $1,000. During the field review, Staff found documentation supporting only $1,931 of the total amount charged to this account, while Valley reported $2,025 in expenses for the test year. Staff recommends that the transportation expense be reduced $94 to result in an adjusted balance of $1,931.

Miscellaneous General Expense. Valley reported $293 for the test year in this account, and no adjustment was proposed. After reviewing Valley's records, Staff found that this expense consisted of two items. The first was a customer deposit refund to Kinder Construction Company of $30 and the second was an annual fee to the Kentucky Gas Association of $263. As explained in the USoA, this account should include the cost of labor and expenses incurred in connection with the general management of the utility. The expense of $30 to Kinder Construction Company is a customer deposit and should be reflected in the balance sheet. Therefore, the refund of $30 should not be included for rate-making purposes. This results in an adjusted balance of $263.

Depreciation Expense. Valley reported depreciation expense of $6,298 for the test year. During 1992, Valley purchased a trencher at a cost of $29,500 and a computer system at a cost of $12,000. Valley proposes an increase of $5,350 to reflect the additional depreciation expense associated with these additions.

In Valley's last rate case, Case No. 89-103,[2] Staff determined that a portion of the utility plant balances was incorrect. In late 1987, the Financial Audit Branch of the

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2 Case No. 89-103, "Adjustment of Rates of Valley Gas, Inc.", Final Order dated November 9, 1989.

Commission's Rates and Tariffs Division performed an audit ("PSC Audit") of Valley for the year ended December 31, 1986. One of the findings in the PSC Audit was that the reported depreciation expense was being calculated using the tax accelerated, rather than the straight-line, depreciation methodology. Valley was instructed to adjust its records to reflect straight-line depreciation and to calculate future depreciation expense using this method only. As a follow-up to the PSC Audit, and in order to determine a reasonable level of depreciation expense for rate-making purposes, In Case No. 89-103, Staff reviewed Valley's compliance with the findings and audit adjustments of the PSC Audit. As Staff's 1989 report indicates Valley did not book all of the adjusting entries relating to utility plant and accumulated depreciation identified in the PSC Audit. Valley omitted entries to its utility plant account relating to customer advances for construction and unrecorded accounts payable. Valley did not book an adjustment to accumulated depreciation which would have restated the account using straight-line depreciation, instead of tax accelerated depreciation. At that time, Staff used the PSC Audit workpapers and report, along with the actual plant additions made by Valley in 1987 and 1988, to recalculate the utility plant and accumulated depreciation account balances at December 31, 1988.

In the instant case, Staff determined that Valley had not utilized the utility plant balances from the prior rate case in some of the plant accounts. Therefore, in determining depreciation expense, Staff began with 1988 utility plant balances, from the

1989 Staff Report and included any additions or retirements to arrive at a balance for the test year. Staff has included in the plant balances the computer and a trencher purchased during 1992. Based on the adjusted plant balances, Staff has calculated an annual depreciation expense of $12,269 as follows:

Acct. No.	Account	Balance 1988	1989-1991 Additions	1989-1991 Retirements	Utility Plant Balance 1991
374	Land	$ 1,094			$ 1,094
376	Mains	136,342	$ 4,143	$(1,505)	138,980
387	Installation Equ	0	780		780
381	Meters	0	450		450
383	House Regulators	0	64		64
391	Furniture & Fixtures	0	751		751
	Computer	0	12,000		12,000
396	Machinery	0	5,000		5,000
	Trencher	0	29,500		29,500
392	Transportation	18,500			18,500
		$155,936	$52,688	$(1,505)	$207,119

Acct. No.	Account	Utility Plant Balance 1991	Depreciation Rate	Expense for Rate-Making
374	Land	$ 1,094		$
376	Mains	138,980	2.50%	3,475
387	Installation Equ	780	10.00%	78
381	Meters	450	3.00%	14
383	House Regulators	64	3.00%	2
391	Furniture & Fixtures	751	10.00%	75
	Computer	12,000	20.00%	2,400
396	Machinery	5,000	10.00%	500
396	Trencher	29,500	10.00%	2,950
392	Transportation	18,500	15.00%	2,775
		$207,119		$12,269

Therefore, Staff has made an adjustment to increase depreciation expense by $5,971 for rate-making purposes.

Sales Tax. Valley proposed to decrease revenues by $8,640 to reflect taxes collected by Valley which are remitted to state and county governments. As Staff has made the appropriate adjustment in the restatement section for the revenue and expense accounts, this adjustment is not necessary.

Taxes Other Than Income Taxes. Valley proposed two adjustments to Taxes Other Than Income Taxes. The first proposal is an increase of $245 to reflect the payroll taxes associated with the proposed wage increase. The second adjustment is a proposal to adjust the PSC assessment to reflect a $379 PSC assessment for 1991.

As explained in the Administrative and General Salaries section, Staff recommends a decrease of $2,500 resulting in a balance of $28,800. Staff calculated payroll taxes based on $28,800 of wages and the Social Security percentage of 7.65%. This results in a Social Security tax of $2,203. Staff then reviewed the employer's quarterly unemployment wage and tax report and determined that the unemployment tax of $374 is correct. Staff combined the two taxes for a balance in payroll taxes of $2,577. Valley reported a balance of $2,698 for payroll taxes for the test year. The difference in payroll taxes results from Staff's exclusion of the bonuses for Administrative and General Salaries. This results in a decrease of $121.

Secondly, Staff has computed the PSC assessment based on Valley's normalized revenues contained in the adjusted income statement using the 1992 assessment rate of .001434. This resulted in a $401 assessment. Valley paid $379 in assessments during the test year; therefore, Staff recommends increasing the assessment by $22. In summary, the combined effects of Staff's recommended adjustments result in a decrease of $99 to a balance of $4,021, which results in a Staff adjusted level of Taxes Other Than Income Taxes of $3,922.

Rate Case Expense. Valley proposed rate case expenses of $3,000 to be amortized over 3 years. Valley has actually incurred $2,134 related to the rate case through the date of Staff's review. Staff has amortized this amount over 3 years which results in an annual expense of $711 for rate making purposes.

Interest Expense. Valley did not propose any adjustments to interest expense. Valley has taken out a loan at First State Bank for $15,000 at an annual interest rate of 8%. This note was due on demand on January 5, 1993. The proceeds from this note were used to purchase the trencher. Valley indicated during the field review that the note would be renewed in January 1993 as Valley does not have the funds to retire it. Staff recommends that interest expense be included for rate-making purposes, in the amount of $1,200.

Based on the recommendations proposed in this Staff Report, Valley's adjusted operations are as follows:

Accounts	Staff Restated Test-Year	Staff Proposed Adjustments	Staff Adjusted Balances
Operating Revenues:			
Gas Service Revenues	$ 235,356	$ 44,257	$ 279,613
Misc. Service Revenues	5,227	-0-	5,227
Total Operating Revenues	$ 240,583	$ 44,257	$ 284,840
Operating Expenses:			
Natural Gas Purchases	$ 136,366	$ 67,080	$ 203,446
Mains & Services	382	(167)	215
Rents	21	-0-	21
Maintenance of Lines	351	-0-	351
Maintenance of Meters	734	-0-	734
Account. & Collect.	1,319	-0-	1,319
Supplies & Expenses	2,231	-0-	2,231
Uncollectibles	688	-0-	688
Admin. & Gen. Salaries	31,300	(2,500)	28,800
Office Supplies & Exp.	2,183	-0-	2,183
Outside Services	26,125	-0-	26,125
Property Insurance	1,078	1,583	2,661
Pensions & Benefits	4,680	2,833	7,513
General Advertising	705	(705)	-0-
Misc. General Exp.	293	(30)	263
Rents	6,000	-0-	6,000
Transportation Exp.	2,025	(94)	1,931
Rate Case Exp.	-0-	711	711
Depreciation	6,298	5,971	12,269
Taxes Other Than Income Taxes	4,021	(99)	3,922
Total Operating Exp.	$ 226,800	$ 74,583	$ 301,383
Net Operating Income	$ 13,783	$ (30,326)	$(16,543)
Other Income:			
Interest & Dividends	$ 1,993	$ -0-	$ 1,993
Other Deductions:			
Interest on Long-Term	$ -0-	$ 1,200	$ 1,200
Non Utility	385	-0-	385
Other Interest Exp.	331	-0-	$ 331
Total Other Deductions	$ 716	$ 1,200	$ 1,916
NET INCOME	$ 15,060	$ (31,526)	$(16,466)

D. Revenue Requirements

In its application, Valley proposed an increase in gas revenues of $30,400. Valley did not indicate how it determined the requested revenue increase.

Staff has reviewed the methods normally used to determine the revenue requirements for gas utilities: Return on Capital and Rate Base, and Operating Ratio. In Valley's last rate case, the Return on Capital and Rate Base method was used. According to the 1991 Annual Report, Valley's Common Equity of $43,792 consists of $86,875 in common stock and a negative $43,083 in unappropriated retained earnings. Valley has debt of $15,000 represented by demand notes. The total capitalization would be $58,792, determined as follows:

		Percentage of Total
Debt	$15,000	25.51%
Common Equity	$43,792	74.49%
	$58,792	100.00%

Staff has also determined the net investment rate base for Valley. The calculation uses the balances for utility plant and accumulated depreciation presented in Attachment A of this report. Staff has reflected the adjustments recommended in this Report and the Commission's normal calculation of working capital. The net investment rate base would be $110,076, determined as follows:

Utility Plant		$207,119
ADD: Working Capital - Operating and Maintenance Expense LESS Natural Gas Purchases	$81,746[3]	
DIVIDED BY:	1/8	10,218
Subtotal		$217,337
LESS: Accumulated Depreciation		107,261
Customer Advances for Construction		0
NET INVESTMENT RATE BASE		$110,076

Normally, under the return on capital approach, revenue requirements are determined by applying the rate of return on capital to the total capitalization to determine revenue requirements. In determining a reasonable rate of return on common equity, Staff has given consideration to the nature of Valley's operations and its economic circumstances. Staff believes that a 12 percent rate of return on common equity is reasonable for Valley under the current economic conditions. This results in an overall rate of return on capitalization of 10.98 percent, shown as follows:

	Percentage		Cost		Overall Rate of Return
Debt	25.51%	x	8%	=	2.04%
Common Equity	74.49%	x	12%	=	8.94%
					10.98%

A return of 10.98 percent will provide sufficient income to meet Valley's needs and provide a reasonable cash flow. The application of a 10.98 percent rate of return on Valley's capitalization would

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[3]

Operating Expenses	$301,383
Less: Gas Purchases	(203,446)
Depreciation	(12,269)
Taxes	(3,922)
	$ 81,746

yield a net operating income of $6,455. This approach would require an increase in Valley's revenues of $22,998.

Valley indicated its required revenue increase was based on a rate of return on net investment rate base of 12.5%. The recommended return on capitalization results in a 5.9 percent rate of return on the net investment rate base determined by Staff. Staff notes that the rate base computed for Valley of $110,076 is $51,284 larger than the total capitalization. The 5.9 percent rate of return on rate base appears low but in effect is not because of the significant difference between the rate base and the total capitalization.

Staff notes that the increase in revenues resulting from the use of an 88 percent operating ratio method would have translated to a 32.6 percent rate of return on Valley's common equity; this clearly would be excessive for a utility like Valley. The increase recommended by Staff using the return on capitalization method produces an operating ratio of approximately 96 percent. Staff believes that the revenue increase calculated using a 10.98 percent rate of return on capitalization provides sufficient revenues to meet Valley's needs. The staff recommends the following determination of revenue requirements and revenue increase for Valley:

Total Operating Expenses		$301,383
Total Capitalization	$ 58,792	
Rate of Return on Capitalization	10.98%	
Required Operating Income		6,455
Revenue Requirement		$ 307,838
Normalized Revenues		284,840
Increase in Revenues		$ 22,998

The revenue increase of $22,998 should allow Valley to meet its operating expenses, and provide for reasonable equity growth. Therefore, Staff recommends an increase in operating revenues of $22,998.

Retail Rates

Staff recommends the following retail rates based upon approximate sales volumes of 49,000 Mcf. This estimate was calculated based on the billing analysis of average bills submitted by Valley in its application.

All Customers, Commercial and Residential:

Rates	Base Rate	Gas Cost Recovery Rate	Total
Customer Charge			$4.00
All Mcf per Mcf	$1.6451	$4.2126	$5.8577

These rates will generate an increase of approximately 8.08 percent in revenue for Valley.

E. Signatures

Gary Forman

Prepared By: Gary Forman
PS Rates & Tariffs Manager
Electric and Gas Revenue
Requirements Branch
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Tammy Page

Prepared By: Tammy Page
Public Utility Financial
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ATTACHMENT A
UTILITY PLANT AND ACCUMULATED DEPRECIATION
PLANT BALANCES
AS OF DECEMBER 31, 1991

Staff calculation of Account Balances:

Acct. No.	Account	Utility Plant Balance	Accumulated Depreciation	Net Plant Balance
374	Land	1,094	0	1,094
376	Mains	138,980	87,515	51,465
387	Installation equ	780	234	546
381	Meters	450	41	410
383	House Regulators	64	6	58
391	Furniture	751	165	586
	Computer	12,000	2,400	9,600
396	Machinery	5,000	1,000	4,000
396	Trencher	29,500	2,950	26,550
392	Transportation	18,500	12,950	5,550
		207,119	107,261	99,858